

DIRECT TESTIMONY

OF

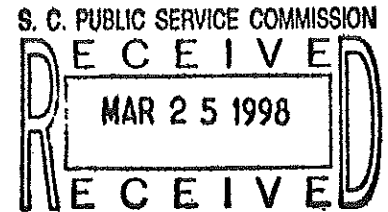
JOHN W. FLITTER

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 98-002-E

POSTED
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1 Q. STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. John W. Flitter, 111 Research Drive, Columbia, South Carolina.

3 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

4 I am Manager of the Fossil Hydro Procurement Department of South Carolina Electric
5 & Gas Company (SCE&G).

6 Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND AND YOUR BUSINESS
7 EXPERIENCE.

8 A. I graduated from the University of South Carolina in 1966 with a Bachelor of Science
9 Degree in Business Administration; majoring in Accounting. I was employed by South
10 Carolina Electric & Gas Company in September, 1966 in the Budget and Statistic
11 Department. I have held supervisory and management positions with the Company
12 beginning in 1973 that include Supervisor-Accounting Special Studies, Manager-Cost
13 Studies and Load Research, Manager-Rate Regulation, Manager-Fossil Fuel Supply and
14 my current position of Manager-Fossil Hydro Procurement. I have previously presented
15 testimony on numerous occasions before this Commission and the Federal Energy
16 Regulation Commission for both South Carolina Electric & Gas Company and South
17 Carolina Generating Company (GENCO).

18 Q. SUMMARIZE YOUR DUTIES AS MANAGER OF FOSSIL HYDRO
19 PROCUREMENT AS THEY RELATE TO FOSSIL FUEL.

RETURN DATE: _____
SERVICE: OK MR

1 A. I am responsible for the planning, development, analysis and implementation of system-
2 wide strategies for the purchase and delivery of fossil fuels for electric generation in a
3 manner consistent with the Company's objective to obtain the greatest ultimate value
4 for each dollar spent, consistent with maximum reliability. I also perform these
5 functions for South Carolina Generating Company's (GENCO) Williams Station.

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

7 A. The purpose of my testimony is to describe procurement and delivery activities for
8 fossil fuel used in electric generation for SCE&G and GENCO.

9 **Q. WHAT ARE THE OBJECTIVES OF THE COMPANY'S FUEL PURCHASING**
10 **PRACTICES?**

11 A. The objectives of the Company's fossil fuel purchasing practices are to provide a
12 reliable supply, the required quality, and reasonable prices of fossil fuels. These three
13 objectives are inter-related.

14 **Q. HOW DOES THE COMPANY ASSURE THE SUPPLY OF COAL NECESSARY**
15 **TO ENABLE THE COMPANY TO PROVIDE RELIABLE SERVICE?**

16 A. The strategy to meet this objective is developed based upon our projected burn levels,
17 our anticipated coal inventory levels and the anticipated availability and price of coal in
18 the marketplace. Of course, maximum assurance of supply could be achieved
19 hypothetically by securing long term contracts for our total requirements. However,
20 doing so would prevent the Company from taking advantage of potentially favorable
21 supply and price changes in the short-term and spot markets. As an effective
22 supplement to our long-term agreements, our short-term contracts have enabled us to
23 assure consistent supplies over a one or two-year period, combining assurance of supply
24 with an ability to meet changing market conditions. In addition, we have maintained an
25 active role in the spot market, making purchases from reliable suppliers to meet our

1 requirements not satisfied by our contracts. Furthermore, our long-term contracts
2 contain variable quantity provisions which enable the Company to increase or decrease
3 contract quantities under certain conditions. This assures us that additional coal will be
4 available under those contracts should it be in our best interest to expand our purchases
5 under them. This also allows us to decrease purchases should our participation in the
6 short-term or spot markets be more advantageous. Finally, we strive to maintain an
7 average coal inventory equal to approximately two (2) months anticipated consumption.
8 This inventory serves several functions. It serves to moderate the overall cost to our
9 ratepayers, while, at the same time, it also protects us against problems in availability,
10 production and deliverability of coal. In some cases, we rely upon inventory to meet
11 supply requirements because of unfavorable market conditions at the time, although
12 such reliance must be exercised with careful consideration of future requirements and
13 operating conditions.

14 **Q. HOW DOES THE COMPANY ACHIEVE THE OBJECTIVE OF AN ASSURED**
15 **QUALITY OF THE COAL IT NEEDS?**

16 A. The Company's contracts for coal supplies and our orders for spot market purchases of
17 coal identify the quality specifications of the coal which it requires. Quality
18 characteristics include: BTU content, moisture content, ash content, ash fusion
19 temperature, volatile, sulfur content, grindability and size. Our contracts for coal
20 supplies and our purchase orders for spot market purchases include upward cost
21 adjustment provisions for shipments which exceed the guaranteed BTU specification
22 and downward cost adjustment provisions for failure of the shipments to meet the
23 guaranteed BTU content. Our newer long term contracts also provide for reduced sulfur
24 content beginning January 1, 2000 as part of our strategy for Phase II of the Clean Air
25 Act. With respect to quality characteristics, our contracts provide for cancellation or

1 rejection, at our option, for failure of the supplier to meet any of the specifications
2 identified in the contract. With respect to spot market deliveries, the failure of the
3 supplier to meet any of the required specifications can result in the cancellation or
4 rejection of deliveries under the purchase order.

5 **Q. HOW DOES THE COMPANY EVALUATE THAT PART OF THE**
6 **COMPANY'S PURCHASING OBJECTIVE RELATED TO "REASONABLE**
7 **PRICE"?**

8 A. In our analysis of fuel purchasing, the reasonableness of the price which we pay for coal
9 cannot be realistically separated from the assurance of an adequate supply of coal
10 meeting our quality specifications. Price is a concept contingent on supply, quality and
11 location and is ultimately related to the value of the coal in the operation of our
12 generating plants, expressed on the basis of cost per MBTU. Price incorporates the cost
13 of fuel, pricing mechanisms and transportation, and must be evaluated under market
14 conditions which are current at the time of the establishment of the price. For example,
15 under certain market conditions, the establishment of a firm price per ton for coal may
16 be preferable to a price which is adjusted periodically based on independent indexes.
17 Under other conditions, the periodic adjustment mechanism may be preferable.
18 Furthermore, it can be considered advantageous to have a variety of pricing mechanisms
19 among coal contracts in order to mitigate or avoid the effects on prices produced by
20 changes in market conditions or indexes which would be exaggerated if pricing
21 mechanisms were identical in all coal contracts.

22 Another consideration in pricing is the information concerning various market
23 conditions which can be useful in evaluating the reasonableness of price. We
24 continually review published data from a variety of public and governmental sources,
25 and are in continuous contact with market participants who provide information

1 concerning various market conditions which we evaluate carefully for our purchasing
2 decisions. Such market data is used in our analysis of current or prospective coal costs
3 to illustrate whether those costs are generally comparable to the market. Because prices
4 are contingent upon current, and to some extent, projected, market conditions and
5 factors unique to each buyer, a simple comparison of coal costs experienced by several
6 purchasers, even electric utilities in the same geographic region, would not itself
7 establish the reasonableness of the prices paid for coal supplies. In the final analysis,
8 there is no single gauge or standard against which to measure the reasonableness of a
9 particular price. Rather, price must reflect the value of the fuel, the supply requirements
10 and quality considerations of the buyer, and the corresponding economic and supply
11 conditions in the marketplace at the time a contract is made. In light of those
12 considerations, the Company has been able to achieve its coal purchasing objective at a
13 reasonable cost to the Company and its customers.

14 **Q. SUMMARIZE THE QUANTITY, QUALITY, AND TERM OF THE**
15 **COMPANY'S COAL CONTRACTS.**

16 A. During the period March, 1997 through February, 1998, the Company purchased
17 approximately 4.5 million tons of coal under long term and short term contracts which
18 represented approximately 82.5% of the requirement for the Company's five coal-fired
19 stations, GENCO's Williams Station and Savannah River Site. The Company presently
20 has coal under long term contract with 10 suppliers for a minimum of 4.5 million tons
21 annually. For the March, 1998 through February, 1999 period, the Company projects
22 to receive approximately 5.8 million tons of coal with minimum contract tonnage
23 representing approximately 77.9% of the total receipts. The quality ranges are from
24 12,000 to 13,000 BTU with a sulfur content of from 0.65% to 2.0%. These contracts
25 are for periods of from two (2) to three (3) years with options to renew or extend for as

1 long as six (6) additional years. The amount of coal under contract will vary from year
2 to year. In our coal contracts, we have been successful in negotiating pricing
3 adjustments whereby the price is not changed for a fixed period of time, usually
4 semiannually or annually. Normally these price adjustments are based on either a
5 predetermined adjustment amount or independent indexes found in Employment and
6 Earnings and Producer Price Indexes, published monthly by the U.S. Department of
7 Labor, Bureau of Labor Statistics. These indexes reflect changes in mining costs to
8 include labor, fuel, explosives, power, equipment, and supplies.

9 Also, some of our contracts have fixed prices for the full term of the contract.

10 **Q. WHAT PRICES HAS THE COMPANY PAID FOR ITS COAL FROM**
11 **MARCH 1997 THROUGH FEBRUARY 1998?**

12 A. Exhibit No. _____ (JWF-1) entitled, "Coal Purchased For Steam Plants", shows
13 the average cost per MBTU of coal purchased in March, 1997 through February, 1998.
14 Based on the long term and short term contracts and the purchases of spot coal during
15 that period, we have seen the cost of coal vary in price from a weighted average high of
16 \$1.0338 per MBTU (\$26.48 per ton) in March 1997 to a weighted average low of
17 \$.9943 per MBTU (\$25.40 per ton) in August, 1997.

18 **Q. HOW HAVE FREIGHT COSTS VARIED FROM MARCH 1997 THROUGH**
19 **FEBRUARY 1998?**

20 A. My Exhibit No. _____ (JWF-1) shows the average freight costs per MBTU for
21 coal purchased for each month. During that period, the freight costs varied from a
22 weighted average high of \$0.5326 per MBTU (\$13.50 per ton) in November, 1997 to a
23 weighted average low of \$0.5124 per MBTU (\$13.10 per ton) in July, 1997.

24 **Q. HOW HAVE DELIVERED COSTS FOR COAL TO INCLUDE FREIGHT**
25 **VARIED FROM MARCH 1997 THROUGH FEBRUARY 1998?**

1 A. Exhibit No. _____ (JWF-1) shows the average delivered cost per MBTU of coal
2 purchased in March, 1997 through February, 1998. During that period, we have seen
3 the delivered cost of coal vary in price from a weighted average high of \$1.5532 per
4 MBTU (\$39.79 per ton) in March 1997 to a weighted average low of \$1.5154 per
5 MBTU (\$38.76 per ton) in the months of June and July, 1997.

6 **Q. WHAT FREIGHT RATE CHANGES HAS THE COMPANY EXPERIENCED?**

7 A. During the period under review for this proceeding, the Company experienced a
8 decrease in its freight rates for the period beginning March, 1997 through February,
9 1998 for the transportation of coal.

10 **Q. WHAT HAS THE COMPANY DONE TO CAUSE THESE DECREASES IN**
11 **FREIGHT CHARGES?**

12 A. During the period under review, the Company signed a new contract agreement with the
13 Norfolk Southern Railroad (NS) which allowed for the competitive deliveries of coal to
14 two of our power stations previously served only by the CSX Railroad (CSX). This
15 followed our previous efforts with the NS that had resulted in competitive deliveries of
16 coal to one other of our power plants in 1996. With the advent of NS delivery
17 capabilities at these three stations plus our preexisting capability for NS rail direct
18 deliveries at our Wateree Station, the Company has been able to reduce its freight
19 charges.

20 **Q. WHAT HAS BEEN THE REACTION OF THE CSX RAILROAD TO THEIR**
21 **LOSS OF THE THREE PREVIOUSLY CAPTIVE POWER STATIONS?**

22 A. CSX filed a lawsuit in Federal District Court against the Company. This suit addressed
23 the tonnage guarantees issue in our contract. A settlement agreement was reached in
24 January, 1998 to resolve the issue.

25 **Q. PLEASE SUMMARIZE THE SETTLEMENT AGREEMENT.**

1 A. The settlement agreement includes reduced rates to all of our power stations, a private
2 railcar provision that will allow for future reductions in freight costs, a lower percentage
3 guarantee, an extended term and a payment to CSX for rate concessions.

4 Q. **EXPLAIN THIS PAYMENT FOR RATE CONCESSION.**

5 A. The Company made a lump sum payment to CSX of less than half the amount the
6 Company will realize in future CSX freight costs reductions through the end of the term
7 of the previous contract.

8 Q. **HAS THE COMPANY PREVIOUSLY REQUESTED AND RECEIVED ANY**
9 **DIRECTIVE FROM THIS COMMISSION?**

10 A. Yes. The Company requested and received approval for special accounting treatment
11 concerning the payment for concessions.

12 Q. **WHAT IS THE COMPANY NOW REQUESTING?**

13 A. The Company request pass through approval for the amortization of the payment for
14 concessions. This would occur by charging the difference between the old higher
15 freight rates and the new reduced freight rates against the concession amount until fully
16 amortized. The amortization period is estimated to be less than three years.

17 Q. **WOULD ALL OF THE SAVINGS FROM REDUCED FREIGHT RATES BE**
18 **USED TO AMORTIZE THE CONCESSIONS PAYMENT?**

19 A. No. Savings accruing for the reduced freight rates with the NS would flow fully to our
20 customers. Our customers would receive the full effect of CSX and NS rate reductions
21 after the approximate three year amortization period.

22 Q. **HAS SCE&G MADE EVERY REASONABLE EFFORT TO MINIMIZE ITS**
23 **FUEL PROCUREMENT COSTS?**

24 A. Yes. As outlined above, we have made every reasonable effort to obtain reliable, high
25 quality suppliers of fuel and transportation at the lowest possible cost to our customers.

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes.

South Carolina Electric & Gas

COAL PURCHASED FOR STEAM PLANTS

March 1997 THROUGH FEBRUARY 1998

